

Corpay[^]

Why Currency
Markets Move &
What you can do
about it

[Corpay.com](https://www.corpay.com)

Managing currency risk in volatile markets

Managing a cross-border business brings with it a range of opportunities for growth, as well as some challenges!

An informed approach to managing global payments and foreign currency exposure—for one payment or thousands—can help your business to save time, protect the bottom line, and take advantage of new opportunities.

The foreign exchange market can feel, well, 'foreign'. What moves markets? Why does one currency weaken and another rise? In the following pages, we'll discuss some of the causes and effects of currency volatility, and strategies for staying on top of foreign currency exposures and mitigating associated risks.

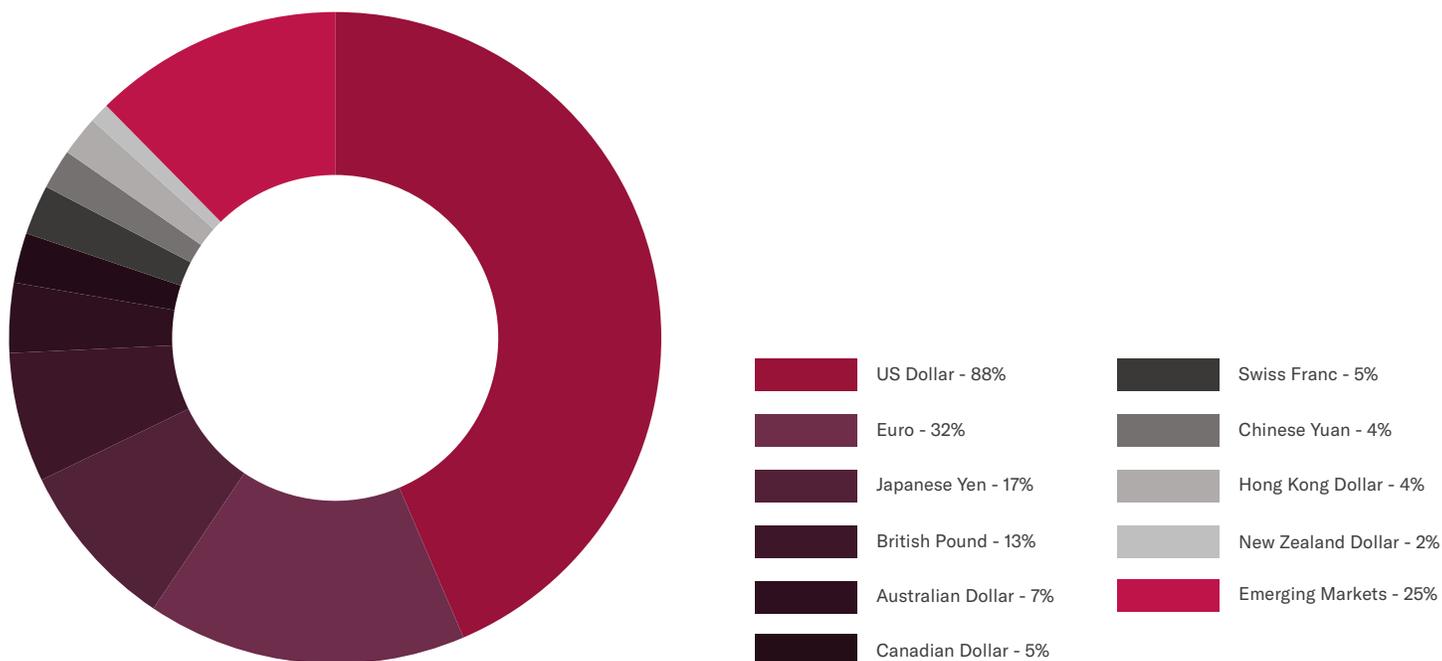
About the foreign currency market

The foreign currency market is the largest and most liquid of the financial markets, trading round the clock six days a week with a daily volume of up to \$6.6 trillion (US)¹. Largely self-regulated, with no central bank, it's often described as an "imperfect" market as participants are there for different reasons and buyers and sellers don't all have the same information (though there are no truly perfect markets outside of economics textbooks).

Participants include central banks, sovereign funds and liquidity providers; brokers; speculative traders (programmatic and individual traders); merchants large and small, multinational corporations. Others are sending and receiving cross-border payments for goods and services; still others are buying banknotes for travel.

Until it was disrupted by the internet, the forex market was dominated by banks. Digitalization revolutionized many industries, including the foreign exchange market, as it opened it up to more players and more innovation.

The most traded currencies: 2019¹



¹Source: BIS Triennial Central Bank Survey 2019

A globalized marketplace

Technology, easy air travel, new trade agreements, demand for raw materials, parts and manufacturing facilities around the world for products that are then sold globally: all these factors have made the world smaller. Mature economies are on the hunt for new resources as well as new markets for goods and services. Emerging markets are hungry for exposure for their goods and services—and conversely, for global goods to purchase—as they seek a place on the larger stage.

Sources of volatility

In an interconnected, globalized economy, several factors can cause fluctuation in the value of one currency relative to another currency. Geopolitical and economic shocks, political and social instability, the fundamental health of the underlying economy, interest rates and inflation, and the balance of trade can all cause currency movement. Some state economies are heavily dependent on one particular export product or commodity (for example **oil exporters like Saudi Arabia and Nigeria**) and such countries' currencies can rise and fall with the price of oil.

In some cases, even a hint of instability or change in monetary policy (such as a change in interest rates set by a central bank) can cause fluctuation.

What are the implications of a weaker or stronger currency? Here's an example: a weaker currency tends to help exporters as their goods are more attractively priced to sell to other markets, but that same weak currency will not go as far as a stronger currency will in the import market.

Types of risk

Depending on what your purpose is in trading in international markets (there's that imperfect market again), you may be subject to different types of risk. Following is a brief discussion of four key risk types.

- **Transactional risk** occurs when one is exchanging one currency for another to buy or sell goods and services. This is the most common kind of risk, as a change in the underlying currency rates can impact your cost and your revenues.

As an example, a US manufacturer orders machinery from Germany to be delivered in three months' time. He computes his cost in US dollars at the market rate at the time of the order. But by the time the machinery is delivered, and the payment is due, the Euro has strengthened and he needs to pay more in US Dollars to fulfill his obligation:

| Euro Cost | USD/EUR | USD Cost | Difference |
|-----------|---------|-----------|------------------|
| €100,000 | 1.12 | \$112,000 | |
| €100,000 | 1.15 | \$115,000 | +\$3,000 (+2.7%) |

(These are hypothetical rates for illustration only)

It just as easily could have gone the other way but locking in the price at the time of the order (e.g., through an FX forward contract) would have given the importing US manufacturer certainty about the cost for this transaction.

- **Translational (balance sheet) risk** affects the value of assets and liabilities held abroad. Translational risk can occur when a foreign-denominated investment, loan, or asset needs to be valued in the home currency (the 'functional currency') for reporting or accounting purposes. If the relative value of either currency changes from one reporting period to the next, it can show up on the balance sheet as a loss or gain.

- **Economic risk** is caused by external factors, such as a natural disaster, a political shakeup, or dramatic change in monetary policy, and typically affect revenues generated abroad. The recent COVID-19 pandemic is an example of a global health risk with enormous economic implications. The war in Ukraine is another such event.
- **Operational risk** can occur at any point in the accounting process. As a business grows and complexity increases, legacy systems and practices for processing transactions, reconciling invoices, and reporting may not keep up. Efficiency (and profits) can be affected by manual errors and the extra time spent to track and correct them; opportunities for growth or investment may be missed as a result.

Managing risk

There are several philosophies about managing currency risk. The ‘hope and pray’ school of thought is firm in the belief that it all evens out in the end for those that neither hedge nor actively manage FX risks. For example, sticking exclusively to FX spot transactions, or using USD for all cross-border transactions may keep things simpler, but may not always be the best strategy for business growth in any market, particularly in a high-volatility environment.

It’s wise to consider factoring in currency risks into your overall business risk analysis, so you can understand the potential impact on the balance sheet. Developing a plan that gives you more certainty about your costs and revenues on both sides of the ledger can play an important role in your business strategy going forward.

A helpful first step can be to identify the type of risks your business may be exposed to, and then working toward a plan that helps you meet your strategic objectives. You may simply need a facility for making a few payments at a targeted rate, or you may need a multi-currency solution that helps you manage hundreds of payments every month as you expand your supply chain or enter new markets.

There is no one-size-fits-all approach: every case is unique. Your plan should be flexible and adaptable to your changing business needs.

As the oft-quoted African proverb says, ‘To go far, go together.’

Consider speaking to a foreign exchange professional who can give you an objective analysis of your exposures, and with whom you can consult on tools and approaches to help you manage risk and achieve more positive outcomes.

Beyond your bank’s foreign exchange desk, there are foreign exchange specialist companies whose services range from moving money efficiently from point A to point B, to providing market insight and consultations regarding hedging and risk management. It’s a good idea to consider what’s most important to you and how you like to work, and to keep an open mind as you explore your options.

Do your homework

Advantages of working with a specialist can include more proactive service and richer strategic support, and more transparency on rates. Do take the time to understand the pricing structure and the capabilities on offer. And make sure the specialist is fully licensed and regulated, and has depth and experience in the market. Some banks and specialists work through intermediaries and partners, which can delay payments and add to the cost.

Don’t discount chemistry: What’s most important is that you find a partner who offers the level of service you need, a full portfolio of solutions, and whom you can trust as an advisor and a resource in navigating the complexities of the FX markets.

To learn more about Corpay Cross-Border Solutions, and to discover whether our solutions and resources could help you master the FX markets, please get in touch!

About Corpay Cross-Border

Global businesses trust Corpay Cross-Border to power their international payments, execute plans to manage their currency risk and support their growth around the world. We aim to deliver unmatched service and expertise with respect to moving money globally. Utilizing our proprietary payment automation technology and currency risk mitigation solutions, we take pride in connecting companies large and small with the global financial markets and businesses all over the world.

You can feel confident working with Corpay, as we are backed by our parent company, FLEETCOR Technologies, Inc. (NYSE:FLT) a leading global business payments company based in Atlanta, Georgia, USA. FLEETCOR is a Fortune 1000 firm, an S&P 500 member and has USD \$2.8B in annual revenue with a market capitalization of USD \$18.2B (as of December 31, 2021). To learn more visit www.corpay.com.

Useful definitions in foreign exchange transactions

Spot transaction: purchase or sale of a foreign currency at the prevailing exchange rate to settle a one-time payment for delivery within two business days.

Currency hedging: Planning and implementing policies designed to reduce risk, increase certainty, and temper the effects of adverse market movement in cross-border transactions.

Forward contract: A commitment to buy or sell a foreign currency at a fixed exchange rate on a specific date to fulfill a future obligation, without tying up all your cash flow (some initial 'margin' may be required). Depending on the currencies, you can book forwards for any length of time (up to 24 months in some cases).

Flexible forward contract: A commitment to buy or sell foreign currency at a fixed exchange rate within a specific date range. It can be drawn down at any time for recurring payments obligations.

Forward contracts can also help you protect the value of incoming payments, by locking in the rate at which you will exchange the foreign currency for your home currency when it is paid to you.

Interbank rate: The published rate for currency conversion, based on what the biggest banks charge each other. Consumer and business rates will typically involve higher spreads than the interbank. And rates change continually.

Spread: What your provider charges you above the interbank rate for your currency purchase or sale. Spreads can vary, depending on factors such as volume and frequency of the payments, and the currency pair itself. Less widely traded currencies are typically more expensive.

Margin: A collateral 'deposit' sometimes required to cover the counterparty's credit risk; usually a portion off the overall contract

Multi-currency holding account and cross-currency trading: The ability to hold different currencies in a single account without separate foreign-denominated bank accounts. This allows you to exchange one currency to fulfill an obligation in another, without having to convert to your home currency first.

FX Option contracts: A regulated instrument that gives you the right (but not the obligation) to purchase currency at a fixed rate at some point in the future, protecting the downside but allowing you to take advantage of the upside should the market move in your favour. Options can be structured with a premium or without. (Foreign exchange options can carry a high level of risk and are not suitable for everyone. If you are in any doubt as to the suitability of any foreign exchange product, you should seek advice from an expert independent of the institution with which you are considering entering an Option contract.)



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